

Holders of Gas and Electricity
Supply Licences, DECC,
Consumer Focus, consumers and
their representatives and other
interested parties



Our Ref: 61/12
Direct Dial: 020 7901 7000
Email: Jemma.Baker@ofgem.gov.uk

Date: 27 April 2012

Dear Colleague,

Proposed reinsertion of SLC 25A for the gas and electricity domestic supply licences until 31 July 2014

After considering responses to our consultation on the proposed reinsertion of the Undue Discrimination Prohibition licence conditions (Gas and Electricity) published on 24 February 2012¹, the Gas and Electricity Markets Authority ('the Authority') has decided to proceed with a statutory consultation as set out in the accompanying notices under section 11A of the Electricity Act 1989 and section 23 of the Gas Act 1986. The Authority has also decided to consult on a proposal to retain the Guidelines on Cost Reflectivity between Payment Methods and the Prohibition of Undue Discrimination in Domestic Gas and Electricity Supply Contracts (the 'Guidelines')².

Background

Standard Licence Condition 25A ('SLC 25A') requires the domestic supplier to ensure that in supplying or offering to supply electricity and /or gas, the Principal Terms on which it does so do not discriminate without objective justification between one group of Domestic Customers and any other such group. The grounds for objective justification and our approach to the enforcement process are set out in the Guidelines for the condition. SLC 25A includes a "sunset clause", to allow the condition to lapse three years after its implementation on 1 September 2009.

In February 2012, we published a consultation setting out our 'minded to' proposals to reinsert the existing Undue Discrimination Prohibition SLC 25A (without amendment other than the date of the sunset clause) for a further two year period, until July 2014. In that consultation we proposed to retain SLC 25A until the impact of the Retail Market Review (RMR) proposals³ were clear and if appropriate, have taken effect. We noted that while we do not consider it is appropriate to conduct a full review of SLC 25A while we are still developing our RMR policies, we may be in a position to undertake this review before the end of the further two year period.

We also asked stakeholders for views on whether it was appropriate to continue to have SLC 25A applying only to those suppliers with fewer than 50,000 customers per fuel and whether it would be appropriate to consider this threshold as a separate consultation.

¹Consultation on the Undue Discrimination Prohibition standard licence condition', Feb 2012, Reference: (23/11)

²See Guidelines on Cost Reflectivity between Payment Methods and the Prohibition of Undue Discrimination in Domestic Gas and Electricity Supply Contracts, 7 August 2009.

³Retail Market Review – Domestic Proposals', December 2011, Reference: (166/11).

Overview of responses

We received 17 responses⁴ to the February consultation. Some larger suppliers recognised the interaction of this licence condition with our RMR proposals and generally supported the temporary extension of the prohibition. This support was, however, conditional on a full review of SLC 25A being conducted at the earliest opportunity. Some suppliers did not, however, support our proposal to re-insert the condition until July 2014.

Consumer bodies had mixed views on the proposed extension of SLC 25A to July 2014. One respondent considered it was appropriate to extend the condition indefinitely and only review if necessary. Another respondent considered it was not clear that the condition had delivered benefits to consumers. This concern was also raised by three academic respondents.

Responses to the customer number threshold question were mixed. Smaller suppliers considered the current licence condition has unintentionally restricted the growth and entry of new suppliers. They also considered that any extension of the condition should involve a review of the threshold. Some consumer representatives expressed concern that smaller suppliers are allowed to have non cost reflective practices.

Those responses which were non-confidential will be placed on our website shortly. We discuss below our view following consultation responses.

Ofgem's view on our proposals to extend SLC 25A until July 2014

We have considered stakeholders' concerns and we do not consider that at this stage we been provided with sufficient evidence and reasons to alter our views expressed in the February consultation.

The Energy Supply Probe (the Probe)⁵ identified a number of price differences which could not be justified by costs. The intention in introducing licence condition 25A was to provide consumers who had never switched supplier with temporary protection from non cost reflective pricing. Evidence from the Probe suggested these consumers were more likely to be with the former incumbent supplier and disproportionately more vulnerable to non cost reflective prices.

The introduction of the sunset clause reflected our expectation that the full implementation of the Probe remedies would ensure retail competition was sufficiently effective to protect these consumers from undue discrimination. In particular, our Probe information remedies were intended to enable consumers to make well informed decisions and increase supplier incentives to compete for these consumers.

However, the Retail Market Review Findings and Initial Proposals⁶ document confirmed the market has not materially changed since the introduction of the Probe remedies in 2009. We found that while suppliers had made changes to implement the informational remedies, they were not in the spirit of the Probe reforms, and in some cases were not fully compliant. In addition, we found that there are still a significant number of consumers that are not active switchers and continue to be disengaged from the market. We also identified a number of features of the market which reduce the effectiveness of competition. Following consideration of responses, at this time we remain of the view that if we allow this licence condition to lapse before we are able to provide further protections through RMR proposals, non cost reflective pricing may return to the market. Similarly, we still consider it is more appropriate to conduct a full review of the need for SLC 25A, and the associated Guidelines once there is greater clarity on the impact our RMR proposals.

⁴ Responses were received from the 'Big 6', Energy UK, First Utility, NEA, Consumer Focus, Good Energy, Ecotricity, Stephen Littlechild, Centre for Competition Policy, Richard Green, and the Energy Supplier Forum.

⁵ 'Energy Supply Probe – Initial Finding Report', October 2008, Reference: (140/08).

⁶ 'Retail Market Review – Findings and initial proposals', March 2011, Reference: (34/11).

We recognise that the Guidelines may need to be reviewed to give consideration to new market developments. However, we consider it is appropriate to review the Guidelines in light of a detailed review of SLC 25A. This will ensure any amendments to SLC 25A as a result of the review can be captured in the Guidelines. In addition, the bespoke enforcement procedure which only relates to this licence condition may also be reviewed as part of any subsequent review of the condition.

Following consideration of stakeholders' views the Authority has decided to proceed with statutory consultations to re-insert SLC 25A until July 2014 and consult on retaining the associated Guidelines to the condition. As with all consultations of this nature, the Authority will make the final decision on these matters following responses to this statutory consultation and in light of any relevant future policy developments. In the event that the Authority decides to reinsert SLC 25A and retain the associated Guidelines, it is intended that this will take effect 56 days after the date the Authority's decision is published.

Ofgem's view on the review of the 50,000 customer threshold

We also consulted on increasing the customer number threshold at which the licence condition would apply. At this stage, the full impacts of any increase to the threshold are unclear, and this issue needs further evidence gathering and review. Our proposal is therefore to retain the existing customer threshold of 50,000 and discuss this issue in detail in a separate consultation within one year. In the meantime, we note that the Guidelines highlight our commitment to apply the licence condition based on a materiality threshold, which includes reference to the number consumers affected.

Responses to the consultations

Relevant licence holders and interested third parties are asked to consider the proposals to reinsert SLC 25A and retain the Guidelines. Any representations on these matters must be submitted in writing on or before 28th May 2012 to: Jemma Baker, Economist, Ofgem, 9 Millbank, London SW1P 3GE or by email to rmr@ofgem.gov.uk.

Where possible, it would be helpful if representations could be provided both electronically and in writing.

Unless marked confidential, all representations will be published by placing them in Ofgem's library and on its website at www.ofgem.gov.uk. Respondents may request that their representations are kept confidential. Ofgem shall respect this request, subject to compatibility with Ofgem's principal objective and duties, and any obligations to disclose information, for example, under the Freedom of Information Act 2000. If you wish to make such a request, please clearly mark your response (or the relevant parts) as confidential and provide a brief supporting explanation.

If you have any queries regarding the content of this letter please contact Jemma Baker (email: Jemma.Baker@ofgem.gov.uk, telephone: 0207 901 7000).

Yours faithfully,

Rachel Fletcher
Partner, GB Markets